FLIPPIN, BRUCE & PORTER

A BUSINESS OF CANTOR FITZGERALD INVESTMENT ADVISORS

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The stock market moved higher during the second quarter of 2023 due in large part to strong performance from a small number of growth stocks. Most of those stocks, which are being called the Magnificent Seven (Meta, Amazon, Apple, Alphabet, Tesla, Netflix and Nvidia), are technology-related companies that received a boost from investor excitement surrounding the prospects for artificial intelligence (AI). Value stocks lagged, with dividend-paying stocks in particular underperforming the benchmarks. The return disparity between dividend payers and non-dividend payers for the first half of the year was the largest seen since 2009 with non-dividend payers leading by 14 percentage points. This performance shift reversed the trend of 2022 when dividend stocks significantly outperformed the market.

The rapid turnaround in market leadership is likely due to several factors. One being the potential of AI and what it could mean for earnings growth for a select group of stocks, some of which are mentioned above. In addition, the widely held view that the Federal Reserve's Open Market Committee (FOMC) has nearly completed its cycle of interest rate increases has benefited growth stocks over more cyclical value stocks. As you are surely aware, the FOMC, led by Jerome Powell, began aggressively raising rates in early 2022 as it became clear that inflation had gotten out of hand, peaking at 40-year highs near 10%. The fed funds rate was raised from near zero to over 5% in just over a year, an unprecedented pace. As we saw in March, there were unintended consequences with stress in the banking sector being the most visible. Another consequence was a repricing of stock valuations with the most expensive segment of the market taking a hit from higher rates last year.

It remains unclear what the next move will be for the FOMC, but the most recent PCE inflation number at just 3.8% is an indicator that the rate increases have contributed to the tamping down of inflation, perhaps proving that the consequences were worth the actions. Furthermore, the fact that stimulative government policies post-Covid are further in the rear view mirror has also helped lower inflation. Powell has implied that the committee may raise rates further, even after pausing at its most recent meeting in June, and that it may leave rates higher for longer to make sure inflation is squelched. Minutes from its June meeting seem to confirm his guidance that more hikes are coming, as the committee noted the resilience of the economy, particularly the labor market. The Fed is in a difficult spot. If inflation doesn't cool due to a slower economy, more rate increases may be needed, putting pressure on the equity markets. If the economy slows too much, a recession will crimp earnings, also putting pressure on equities. For now, investors seem to be looking past the risk of more increases and may even be pricing in a rate cut late this year or early in 2024. This view that lower rates may be on the horizon seems to have prevailed in the battle for investor emotions. Subsequently, stock prices, particularly the growth stocks mentioned above, have moved higher this year.

Most economists have been forecasting a recession since the first rate hike last year. These expectations may very well come to pass late this year or in 2024, but economic indicators today point to continued strength, confounding the experts. Earnings have generally held up much better than expectations as well, providing support to the overall market. Given the strong performance year-to-date from the S&P 500, equity markets may tread water until the future economic environment becomes clearer. The market is richly priced at over 20 times estimated earnings, boosted by very high multiples for growth stocks. Value and dividend strategies appear much more reasonable in the 10 to 14 times earnings range. As we move through the balance of 2023 and look into 2024, we expect a better earnings environment, lower inflation and a more accommodative Fed which should be supportive of a broader improvement in equity prices.

Our Equity & Dividend Plus account performance trails the S&P 500 and the Russell 1000 Value benchmarks this year and for the last twelve months. This comes following significant outperformance seen in the first half of 2022. Longer-term results remain competitive with the value index. Cash flow generation from dividends and option premiums has met expectations so far this year. Our objective is to generate 5% cash flow from dividends and call option premiums, and we are on track to accomplish that goal. Portfolio activity for the quarter included sales of Lincoln National, Paramount and Advance Auto following news that each had weaker than expected earnings and deteriorating fundamentals. Added to the portfolio were Hewlett Packard Enterprise, International Flavors & Fragrances and Travelers.

We encourage you to contact us with any questions you may have. For additional firm wide information please visit our website at www.fbpinc.com or call us at 1-800-851-3804. As always, we appreciate your continued interest in our firm.